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C O N F I D E N T I A L SECTION 01 OF 02 ISTANBUL 002195

SIPDIS

STATE FOR E, EB/IFD/OMA AND EUR/SE
TREASURY FOR OASIA - MILLS AND LEICHTER
STATE PASS USTR - NOVELLI AND BIRDSEY

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TAGS: PGOV ECON EFIN TU
SUBJECT: LIMITED COPENHAGEN FALLOUT FAILS TO PROVIDE RELIEF TO TURKISH MARKETS

REF: ANKARA 9075

Classified By: Consul General David Arnett.
Reasons: 1.5 (b) and (d).

¶1. (SBU) Summary: The week after Copenhagen has been a tough one on Turkey's financial markets. The Istanbul Stock Exchange (ISE) has slumped dramatically, losing over 14 percent of its value, the Turkish lira has depreciated 7 percent, and interest rates on lira-denominated Treasury bills have spiked up to over 55 percent (a rise of 5 percent). Istanbul market analysts ascribe the declines, however, not to disappointment with the summit's outcome, but to a return to the country's "real" agenda. That agenda, they suggest, was largely drowned out in the media build-up to Copenhagen. But now, attention is again returning to the other issues and risks before Turkey, including notably the prospect of an imminent military operation against Iraq and political uncertainty surrounding a new and largely untested majority government. As for Copenhagen itself, analysts ascribed its lack of resonance not just to the decision's openness to interpretation, but to a concerted effort by Turkish government, business, and media to spin it positively. End Summary.

¶2. (U) Unsettled Markets: Markets have been active and unsettled over the last week. In the first two days after the summit, the ISE slumped nearly 12 percent. After stabilizing briefly, it resumed its downward trend on Thursday, December 19. The lira and interest rates, Turkey's other two key economic indicators, responded similarly, with interest rates spiking back up to the mid-50s, and the lira again depreciating to a rate above 1.6 million to the dollar.

¶3. (C) EU Blues: Though increasing optimism in the run-up to Copenhagen about the prospects for a firm starting date for negotiations sparked fears that the markets would react negatively to the eventual outcome, in fact comment and reaction has been muted. Cem Akyurek, research director at Global, Turkey's largest brokerage, attributed the reaction to a concerted effort by government, business, and media to put the best face on what he characterized as a "strikingly negative" decision. Easing the task were the conflicting opinions about the outcome not just in the Turkish and international press, but from European and other leaders. Akyurek, who has been sceptical about AK's economic policies and leadership, also gave the government grudging credit for its "mature" response. He pointed to the government's message that it remains committed to pressing forward on reform as an essential balm for the market, a view echoed by other analysts. Bender Securities, for instance, characterized the "EU anchor" as a key positive over the long term in its daily market report.

¶4. (C) The "Real" Agenda: The market's ability to come to terms relatively quickly with the Copenhagen outcome has not provided overall relief, however. Most analysts ascribe the negative trend to concern about Iraq and the prospects for imminent military action. Others point also to initial missteps by the new government, particularly in the economic field, where lack of coordination has brought conflicting messages on issues ranging from Turkey's new public tender law (and whether the government plans to delay its implementation or not) to return of a portion of the compulsory savings accounts collected by the government in past decades. On these issues, analysts remain divided. Akyurek remains strikingly pessimistic about AK and its plans, noting that the mixed messages he and visiting investors have heard in Ankara also extend to such key issues as maintenance of primary surplus and inflation targets. Others, however, are more sanguine: HC Istanbul Director Elif Zapparoli told us that she would be "shocked" if AK actually made good on those suggestions. "These guys are in this for

the long haul," she suggested, and "will not jeopardize their position by picking a fight with the IMF." (Note: Akyurek's boss, Global Chairman Mehmet Kutman, also falls in this "optimist" camp. In a recent mailing, he effusively characterized the AK government as "young, hardworking, and highly disciplined," suggesting that for the first time in "recent memory" it offered Turkey "the possibility of government in the spirit of public service.")

¶5. (C) Iraq: For Istanbul's market analysts, Iraq remains the new key wildcard. Most ascribe recent market dynamics to increasing concern about the prospects for imminent military action, and the potential costs Turkey will face. Drawing on the experience of the Gulf War, some studies estimate the potential impact on Turkey in the tens of billions of dollars. (A recent-- albeit seriously flawed-- study by the Foreign Economic Relations Board estimated Turkey's losses at 15-20 billion dollars). Analysts admit that the issue cuts both ways, however. In his recent letter, Kutman conceded that the costs of an operation "will be very much outweighed by the benefit...of having a stable and democratic government in Iraq." Zapparoli echoed these sentiments, while Akyurek also saw a safety net in the market's belief that given Turkey's strategic importance, neither the U.S. nor the IMF would permit it to fail.

¶6. (C) Comment: Despite their disappointment, Turkey's markets have reacted calmly to the Copenhagen decision. But at the same time, they have taken off the rose-colored glasses through which they filtered all other developments. With increasing uncertainty surrounding Iraq, and growing concerns about government policy, markets are likely in for a bumpy ride until the former situation is resolved, one way or another, and until the government imposes more discipline in conveying its economic message. End Comment.

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